



U.S. DEPARTMENT OF COMMERCE  
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To: HONORABLE WALTER STOESSEL  
MR. NORMAN BAILEY

From: Lawrence J. Brady  
Assistant Secretary for  
Trade Administration

Attached is the Commerce paper on the  
Extraterritorial Application of U.S.  
Oil and Gas Controls. The paper discusses  
both the effects on the pipeline as  
well as the legal authorities raised by such  
application of the controls.

Not referred to DOC. Waiver applies.

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EXTRATERRITORIAL APPLICATION  
OF U.S. EXPORT CONTROLS  
ON OIL AND GAS TECHNOLOGY AND EQUIPMENT

Introduction

This paper addresses two important questions relating to the extension of the December 30 export control sanctions in the oil and gas pipeline area. Questions addressed concern:

- 1) the effects on construction of the Siberia to West European gas pipeline from extension of oil and gas controls to U.S. controlled foreign firms and to licensees of U.S. technology; and
- 2) the statutory authority and jurisdictional conflict issues raised by the imposition of controls that have extraterritorial effects.

Issue

Successful extension of the controls imposed could restrict critical equipment needed by the Soviet Union for pipeline construction. Turbines are needed to provide power for compressing the gas and moving it through the pipeline. By extending controls, the Administration would significantly strengthen its ability to stop or significantly delay construction of the pipeline.

Present Commerce regulations prevent U.S. origin components or commodities from being used on the project. Sources exist abroad, however, that are either U.S. controlled foreign firms or licensees of U.S. technology that could provide the needed hardware.

The issue is that if the United States wishes to inhibit construction of the pipeline, it must have the means to do so. One means is the extension of U.S. controls. A brief analysis of the effect of such action on eventual construction of the pipeline is presented first, followed by an examination of the legal authorities.

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1. EFFECTS ON THE PIPELINE OF EXTRATERRITORIALAPPLICATION OF U.S. OIL AND GAS CONTROLS

The effective extraterritorial application of U.S. export controls on oil and gas equipment could restrict critical equipment the Soviet Union needs for construction of the Siberia to West European gas pipeline. By extending controls, the United States has a high probability of delaying substantially, if not blocking all together, eventual completion of this project.

Discussion

One key area for extension of controls are the 41 compressor stations (125 turbines) needed to pump the gas from the Siberian fields to West European consumers. Without turbines and compressors, the gas cannot be moved from the source of production to the European market. U.S. technology and products continue to dominate in this area of oil and gas transmission and, therefore, are preferred by Soviet leaders.

Contracts for the compressor stations amount to about \$1.6 billion. The Soviets have selected G.E. designed turbines for the pipeline. The 125 turbines required for the pipeline are to be supplied by European manufacturing associates of G.E.: AEG Kanis (FRG) 49; Nuovo Pignone (Italy) 57; John Brown Ltd. (U.K.) 21. G.E. turbines are preferred by the Soviet Union since they already have nearly 250 such turbines operating on existing Soviet pipelines.

G.E. supplies rotors and critical components for the turbines from the United States. This contract is worth about \$175 million to G.E. Prior to the Presidential action to impose sanctions, G.E. supplied 20-25 of their rotors and component sets to their European associates. The manufacturing associates are now prohibited by U.S. export control regulations from reexporting the turbines with U.S. parts to the Soviet Union. Implementation of the regulations in this manner is consistent with previous Commerce and interagency interpretations.

There is, however, one French firm, Alsthom Atlantique, who is a G.E. licensee and can produce the entire turbine, including the rotors and parts, traditionally U.S. supplied. Alsthom has a contract for 40 engine sets which they could use to meet the needs of the G.E. associates or their own turbines. Alsthom contracted with Misco European (U.K.) and Microfusion, S.A. (France) to produce the 40 rotor components. The process manufacturing technology for such production was transferred by the Howmet Turbine Components Corporation from their Hampton, Virginia facility shortly before the sanctions were imposed.

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The other alternative to G.E. turbines is Rolls Royce. The British produce an aero-derivative engine (RB-211) which is the only real substitute for the G.E. turbine. The Rolls engines uses a Cooper (as in Cooper-Bessmer) load turbine when used with a compressor; this coupling device is a product of U.S. technology.

In addition, Dresser France, a wholly owned subsidiary of Dresser Industries, Texas, has contracted to supply 20 compressors from France. If built in the U.S., they could not sell the compressors; but under present regulations, they can ship from France to the USSR freely.

Several salient points need to be highlighted:

1. Recent reports from Paris indicate that even through Alstom knows how to produce the turbines, including the critical components such as rotors and shafts, they may decide not to produce them due to investment/management considerations;
2. The Soviets are very reluctant to use Rolls Royce engines for compressors and the only other substitute would be Brown Boveri (Switzerland) but engineers question the satisfactory application of this product to the pipeline.

### Summary

In summary, the extension of controls extraterritorially to U.S. subsidiaries or U.S. controlled foreign firms would probably delay the pipeline a minimum of two and perhaps three years, if the extension withstood a court challenge. Extending controls to foreign licensees of U.S. companies, manufacturing oil and gas equipment from U.S. technology could delay pipeline construction a number of years, probably four to five at least. There is a possibility that such action might stop the project altogether. Without the extension of controls, the pipeline will be delayed, at most, one or maybe two years. With the extension, the delay could be four to five years or perhaps prevent its construction altogether. Such a delay could have a serious impact on the Soviet economy.

The estimated delays are predicated on the controls being reasonably effective. Obviously, foreign cooperation would enhance the chances of achieving the objective of a significant delay in pipeline construction. If U.S. controls were extended extraterritorially, the Soviet Union might have no other choice but to rely on domestic turbines and compressors. Such an alternative is not believed to be acceptable because of the Soviets limited turbine production capacity and the inefficiencies of domestic units.

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## 2. STATUTORY AUTHORITY AND JURISDICTIONAL CONFLICT ISSUES

### I. INTRODUCTION

#### A. Procedural Requirements

As discussed below, a decision to amend the regulations to assert control over foreign products of U.S. technology exported before the December 30, 1981 expansion of oil and gas controls would not be based on any express "warning" or reservation of authority in the regulations. Under these circumstances, the U.S. should, as a minimum, give advance word of the broadened control to its allies and give affected U.S. and foreign companies notice and an opportunity to be heard. This should be done by publishing the new regulations in proposed form and arranging for delivery of copies to affected companies outside the U.S. Deficiencies in giving timely and effective notice could be raised against us as failures to observe the procedural admonitions of the Export Administration Act. (See, e.g., 50 U.S.C.A. app. §2402(10), 2412(b)).

Before the President can impose oil and gas controls on the export of foreign origin items by U.S.-controlled foreign firms, he must fulfill the EAA's procedural requirements, including consideration of the statutory criteria relating to the effectiveness of such controls, consultation with industry and Congress, and a determination that notwithstanding foreign availability of the controlled items, the absence of these controls would be detrimental to U.S. foreign policy. (50 U.S.C.A. app. § 2405(b)(c) and (d); § 2403(c)). After controls are imposed, the Secretary of Commerce must report to Congress on the consideration of the statutory effectiveness criteria, on the alternative means attempted, and on how the controls will further U.S. foreign policy (Id. §2405(e) and (g)).

#### B. Summary of Position

The conventional reach of U.S. export controls involves issues of extraterritoriality and the potential for jurisdictional clashes because we assert control over goods

and technology that have left the United States. Two contemplated extensions of extraterritorial jurisdiction pose special problems.

One change would seek to stop foreign-produced equipment from going to the pipeline if it was based on U.S. technology, even though the technology was received prior to the controls. The authority under the Export Administration Act (EAA) for such retroactive or post-export assertion of jurisdiction is dubious and this action would be especially hard to justify under international legal principles.

The other change would control foreign-origin technology or equipment for the pipeline if it is to be supplied from abroad by a U.S.-controlled firm. There is U.S. statutory authority for this approach, but it risks a direct clash of jurisdiction with foreign governments who reject the idea that a subsidiary established in a country has the nationality of its foreign owners. These governments can and do assert the primacy of their territorial jurisdiction over goods and transactions within their borders.

The greater the economic or political stakes for foreign governments, the greater the likelihood that they will use their territorial jurisdiction to try to frustrate unilateral U.S. extraterritorial controls opposed to their interests. Actions could include ordering companies within their territory not to comply with U.S. directives, eliminating U.S. ability to control local companies and barring cooperation with U.S. investigation and enforcement efforts by persons within their territory.

In cutting off future exports from the U.S. for the pipeline project, the U.S. acts with the solid basis of territorial jurisdiction. The effectiveness of this action depends upon when and to what extent adequate foreign substitutes are available to the U.S.S.R. pipeline project.

As to the legal enforceability of the contemplated controls, the Department of Commerce can usually take swift administrative action to deny export privileges notwithstanding jurisdictional or evidence-gathering problems. Of course, this may just punish the offending

foreign company without stopping the transaction. There is also a high risk that U.S. courts would block enforcement of the contemplated retroactive control and the possibility that the courts would bar enforcement when the company's action was compelled by the government of the country where it was operating. It is possible that the U.S. could be enjoined within thirty days of the issuance of new controls.

These issues of control authority, foreign legal actions and the extent of pipeline dependency on U.S.-controlled supplies are set forth more fully below.

## II. Jurisdiction Based on U.S. Origin of Goods or Technology

### A. Basic Authorities and Practices

The EAA gives the President broad authority to prohibit, for foreign policy reasons, the export of goods or technology "subject to the jurisdiction of the United States" (50 U.S.C.A. App. § 2405(a)). This term is not defined in the statute or its legislative history.

Under the Export Administration Regulations (EAR), the Department's Office of Export Administration (OEA) has exercised the broad authority to control three general types of foreign transactions: (1) reexports of U.S. goods (15 C.F.R. § 374.2 (1981)) and technology (*Id.* § 379.8); (2) exports of foreign-end products incorporating U.S. parts and components (*Id.* § 376.12); and (3) exports of foreign products of U.S. technology (*Id.* § 379.8(a)(3)). (The latter two types of foreign transactions can be viewed as involving the "reexport" of the U.S.-origin components or technology involved, but the EAR use the term "export" to describe these transactions).

### B. Reexports and Foreign Products with U.S. Parts

Reexports are the further shipment of U.S.-origin goods or technology intact from an importing country, such as France, to a third country, such as the U.S.S.R. When U.S. goods and technology are exported from the United States, U.S. exporters and foreign importers know that the items may

later be subject to control at the time of reexport. (See Id. §§ 374.2, 379.8). Thus, the OEA exercises the President's broad statutory power by controlling reexports at the time of initial exportation from the United States, i.e., when the goods or technology are still subject to U.S. territorial jurisdiction.

The EAR restriction on the export from foreign countries of foreign end-products incorporating U.S.-origin parts and components also subjects foreign transactions to control after the export from the United States; however, unlike the reexport provisions cited in the preceding paragraph, the parts and components provisions are unclear as to when, after export, such control will be exercised. Two times are possible: (1) at any time prior to incorporation of the U.S. component into a foreign end product to be exported to another country, or (2) at any time prior to the export from the foreign country of the end product. OEA in practice exercises control at the latter time.

While these exercises of control do not clearly fall within internationally recognized principles of jurisdiction, they are defensible. The OEA imposes these post-export restrictions at the time of export -- when the items remain within U.S. territorial jurisdiction.

### C. Foreign Products of U.S. Technology

A more difficult legal question involves the export from foreign countries of foreign products of U.S. technology. This difficulty stems from the fact that, contrary to the above mentioned reexport and parts and components controls, the EAR have not expressly reserved the right to subject the technology's foreign products to later U.S. controls when they are exported from a foreign country to the U.S.S.R.

The EAR are silent as to whether applicable controls should be those in effect (1) at the time of the export of the technology from the United States or (2) at the time of the export of the product of that technology from the foreign country. (See 15 C.F.R. § 379.8(a)(3)) Commerce in the past has informally adopted the former interpretation. The latter interpretation makes the controls on foreign products of U.S.

technology consistent with the reexport provisions and the parts and component regulation. It can also be argued that this interpretation helps to achieve the objectives of the statute. The counter argument is that such retroactivity should not be presumed, especially in light of express reservation in other sections of the right to apply post-export changes in controls.

In sum, the legal grounds are tenuous for what amounts to retroactive control after the technology is already outside U.S. territorial jurisdiction. There is a very high risk that U.S. courts would not uphold an attempt to amend the foreign product of U.S. technology regulation so that it would cover foreign exports involving technology exported prior to the new controls. Moreover, as is discussed in Section IV, foreign countries could frustrate the implementation of such amended regulations by statutes or other legal means.

### III. Authority to Control Foreign Subsidiaries

The legal issue raised is whether the President has authority to control foreign origin exports by U.S.-controlled foreign firms. The EAA gives the President the power to prohibit or curtail exports by "any person subject to the jurisdiction of the United States." (50 U.S.C.A. app. § 2405(a)). The legislative history behind that phrase shows that Congress intended it to cover U.S. owned or controlled foreign companies. There is no statutory requirement that U.S. origin goods or technology be involved.

This presidential authority was added to the EAA in 1977, with legislative history that it was to be used sparingly in view of international repercussions. The effect of that 1977 amendment has been "to broaden the potential reach of peacetime, non-emergency foreign policy controls to exports by foreign subsidiaries of all products and data (not merely strategic) to all destinations (not merely the embargoed nations and other Communist countries)." (Abbott, Linking Trade to Political Goals: Foreign Policy Export Controls in the 1970s and 1980s, 65 Minn. L. Rev. 739, 847 (1981)). During consideration of the EAA in 1979, the Senate acknowledged that the arguably broadened effect "may not have

been considered adequately by the Congress at the time the provision was adopted;" however, it withdrew an amendment that would have eliminated the 1977 authority with respect to reexports from COCOM countries "pending further study." (S. Rep. No. 169, 96th Cong., 1st Sess. 11 (1979)). The authority to date has been exercised once and never tested in court. Its sole use was pinpointed to provide a contractual excuse for nondelivery of foreign manufactured Levi's uniforms for Moscow Olympics participants (15 C.F.R. § 385.2(d) (1981)).

Controls on exports by U.S.-controlled foreign firms have been imposed by Treasury under the authority of the Trading with the Enemy Act (50 U.S.C.A. App. § 5(b)). The same jurisdictional reach is in the International Emergency Economic Powers Act (Id. § 1703(a)(1)). In practice, the extraterritorial reach of the Treasury-administered controls, such as the Cuban embargo, has been cut back over the years in the face of foreign government protests and challenges (Compare 31 C.F.R. § 515.541 (1975) with Id. § 515.559 (1981)). The more recent Iranian Assets Control Regulations did not require licenses for exports of goods and technology by non-banking U.S.-controlled foreign firms (31 C.F.R. §§ 535.207, .429, and .430 (1980)).

### III. Foreign Legal Reactions and U.S. Responses

The legal issue raised is what legal actions foreign governments can take in response to the contemplated U.S. oil and gas controls and how the United States can respond.

Foreign governments have two legal courses of action available to them. First, they can frustrate the successful implementation of controls on foreign products or foreign subsidiaries by statute or by court action. For example, the United Kingdom's protection of Trading Interests Act authorizes the U.K. Secretary of State for Trade to issue orders barring companies that trade in Britain from complying with foreign legal requirements if those requirements are damaging or threatening to damage U.K. trading interests : (Protection of Trading Interests Act, 1980, c. 11, § 1). Such a statutory provision could be used to prevent compliance with the proposed U.S. oil and gas export

controls. In the absence of such a statute, a foreign court may frustrate implementation of the controls by compelling the foreign firms to complete the export transaction. In 1965 this occurred when the French courts in the Fruehauf case removed the foreign subsidiary from the U.S. parent's control and thus from U.S. jurisdiction -- at the request of the French minority directors. (Fruehauf Corp. v. Massardy, (1965) La Semaine Juridique II 14274 (bis) (Cour d'appel, Paris), (1965) Gaz. Pal. II 86, 5 Int'l Legal Mat'ls 476, reprinted in A. Lowenfield, Trade Controls for Political Ends § 3.3 at 81 (1977)).

Second, even if other countries do not attempt to frustrate the successful implementation of the proposed oil and gas controls, they may prevent U.S. enforcement actions against offending firms operating in their countries. Many countries have legislation that would prevent disclosure of information to foreign enforcement officials. Some of these statutes would impose criminal liability on U.S. nationals seeking documentary evidence or testimony in a foreign country to support an alleged violation of the oil and gas controls (See, e.g., Law No. 80-538 [1980] J.O. 1799 (France); S. & GB, C.P., Code Pen. § 271 (1971) (Switzerland)).

The United States could respond to these potential foreign reactions by suspending the U.S. export privileges of foreign firms violating U.S. controls (15 C.F.R. §§ 387.1(b), 388.3 (1981)). The suspension can be achieved through administrative hearings and would not require the gathering of evidence abroad. Such U.S. sanction might induce a foreign company that is dependent upon continued access to U.S. goods and technology to persuade its government to moderate its response to U.S. controls. Such unilateral action on our part could, however, well lead to serious trade problems in the future.

Faced with such a severe sanction, an offending firm may sue the United States Government, alleging that the controls are beyond the President's authority under the EAA or that the controls were unconstitutionally imposed (e.g. lack of due process, arbitrary and capricious). In addition, a foreign firm, lawfully compelled by its government officials or by

its courts not to comply with U.S. controls, may ask a U.S. court to enjoin U.S. sanctions on the ground that it was acting under compulsion from a sovereign power. The court would probably grant this request if (1) the compelled firm is a national of the compelling state, (2) the compulsion was directed only at conduct within the territory of the compelling government and (3) the compulsion was not induced by the firm. (See 1 J. Atwood & K. Brewster, Antitrust and American Business Abroad, 268 (1981); Restatement (Second) of Foreign Relations Law of the United States § 40 (1965); U.S. Dept. of Justice, Antitrust Guide for International Operations 55 (1977)). If a court sustained such challenges, its ruling could affect not only the U.S.S.R. oil and gas controls but other export controls as well.